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No. 7604

IN THE

United States Circuit Court of Appeals

For the Ninth Circuit

WISE MANUFACTURING COMPANY (a corporation),

Appellant,

vs.

E. W. OLIN, RALPH SITES and BERKELEY PATTERN WORKS,

Appellees.

BRIEF FOR APPELLANT.

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PERNAU-WALSH PRINTING CO., SAN FRANCISCO

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INTRODUCTION.

The Wise Manufacturing Company is a California corporation. On May 24, 1934, it was adjudged a bankrupt by an order made in the Southern Division of the United States District Court, Northern District of California. (p. 32.) It appeals from this order. (The references in parentheses will be to the pages of the transcript. Where the reference is to the testimony of a witness, the name of the witness will be given.) The trial was by the court without a jury, and upon an amended petition filed June 7, 1933 (p. 12), and the answer thereto. The original petition was filed March 30, 1933. (p. 6.) The record presents the evidence on which the order was based.

The petition was filed by three creditors, to-wit: E. W. Olin, Ralph Sites, and Berkeley Pattern Works. (p. 3; p. 8.) The amended petition charged that the corporation had concealed certain of its assets for the purpose of hindering, delaying and defrauding its creditors, that the assets so concealed consisted of a certain contract dated February 27, 1930 (p. 9), and a certain bank deposit made in the year 1931. (pp. 10, 11.)

As to the contract of February 27, 1930, it is alleged that this contract was made by Roy T. Wise, president of Wise Manufacturing Company, and that he controlled said company and that Ambrose N. Diehl and Will H. Hays were parties to this contract and that the contract recited that Wise would cause the said company to transfer to Wise Patent and Development Company, a corporation to be organized under the laws of Delaware, certain patents owned by Wise Manufacturing Company, covering the Wise Multi-Speed Transmission and that this would be in consideration of the sum of $75,000.00 to be paid by these three individuals; that the Delaware Company was formed and the patents transferred and that the consideration named in the contract is sufficient to satisfy the claims of all creditors of Wise Manufacturing Company; that the said patents were the "only assets of any considerable value owned by respondent"; "that no consideration was or ever has been received by the respondent for said United States patents"; that "the said contract, as a valuable asset of respondent corporation, was and has been secreted

and wholly concealed by respondent corporation from the creditors of respondent corporation"; that the "petitioners were totally unaware of the existence of said contract and had no knowledge thereof until the 30th day of March, 1933, on which day the existence of said contract was first revealed to your petitioners". (p. 9.)

As to the bank deposit of $605.00, it was alleged that this money was derived in the year 1931 from sales of certain tools, machinery, etc. It was not alleged that the sales were fraudulent. It was charged that the money was fraudulently and secretly deposited in the West Berkeley Branch of Bank of America in the name of H. Jacobson; that this money, "is the property of respondent" and that petitioners were "totally unaware" of this concealment until April 27, 1933. (pp. 10 and 11.) It is alleged:

> "That respondent received the approximate sum of six hundred and five dollars ($605.) from said sales. That said respondent, through its president Roy T. Wise, with intent to hinder, delay and defraud its creditors, caused the said approximate sum of six hundred and five dollars ($605) to be deposited in the West Berkeley Branch of the Bank of America, Berkeley, California, in the name of H. Jacobson. That the above mentioned sum of six hundred and five dollars ($605) *is* the property of respondent, and was and has been concealed and secreted by the said Roy T. Wise from the creditors of the respondent. That your petitioners were totally unaware of the said sale and fraudulent concealment of these assets, and had no knowledge thereof until the 27th day of April, 1933, on which

date the above mentioned transaction was first revealed to your petitioners." (pp. 10 and 11.)

The court will note that when the foregoing pleading was framed, it was the theory of the plaintiff that to constitute concealment of this deposit, it was necessary to show not merely the fact that concealment was not known until within four months prior to the filing of the petition, but that it was essential to show that the asset alleged to have been concealed was in existence and was concealed within the four months period. The word "is" is used. Throughout the trial of the case, appellant insisted that Section 21, Chapter 3, Title 11 of the United States Code, Section 3 of the Bankruptcy Act, meant that there could not be an act of concealment within the four months period unless the property concealed existed in said period.

First it will be noted that the answer denied in detail that there had been any concealment of the contract of February 27, 1930, for the purpose of hindering, delaying or defrauding creditors of Wise Manufacturing Company; that the answer denied that said contract contained the provision relied on for the payment of $75,000.00; that the answer proceeded to set forth, in effect, that there was no contract which contained the substance of the contract alleged in the petition; that while the contract of February 27, 1930, provided for the payment of $75,000.00 in a certain way, this payment was to be upon condition, and that the contract of February 27, 1930, had been substantially varied and modified by two later contracts, the one dated May 8, 1930, and the other dated Septem-

ber 1, 1930, and that the provision for paying the $75,000.00 to the corporation was eliminated. The answer alleges that these contracts were made with a view to raising funds *to pay off* the creditors of Wise Manufacturing Company and to provide funds to buy up the stock of that company and another company, the Standard Die & Tool Company, which owned nearly all the stock of Wise Manufacturing Company. Concealment of the contract of February 27, 1930, or of any contracts is specifically denied and it was likewise specifically denied that there had been any concealment of any property of said corporation within four months of the filing of the original petition on March 30, 1933, or within four months of the filing of the amended petition on June 7, 1933.

The answer admitted the sale of the tools, machinery, and equipment for $605.00. It alleged that Roy T. Wise, president of the corporation, in order to make it possible to distribute this money equally, did deposit the same in the name of H. Jacobson for the purpose of preventing its being attached and for the purpose of preventing anyone from obtaining a preference thereby; that the deposit was not for the purpose of concealment with intent to hinder, delay or defraud any creditor, and that in the year 1931 this money was largely paid out by Wise and that most of the balance was withdrawn by H. Jacobson to pay herself wages and that the remainder was applied by Wise in paying a claim for legal services; that this all occurred in 1931. Then it was denied that there was any concealment of this property within four months of the filing of the original petition, or

within four months of the filing of the amended petition. (pp. 13, 31.)

The court will note that the trial court in Finding V (pp. 36 to 41) proceeded to set out at length a fraudulent conspiracy between Roy T. Wise, the president of the corporation, Will H. Hays and Ambrose N. Diehl. It is found in effect that these three men formed a plan to obtain "without adequate or *any* consideration" (p. 40, top) the patents from the corporation; that the contract of February 27, 1930, was a part of this theft and as to the $75,000.00, it was found that this sum was "to be paid to the respondent from surplus accumulated over the expense of operating such proposed Wise Patent and Development Company, at such times as funds should be available". (p. 38.) The finding as to the promise to pay the $75,000.00 was wholly unsupported. (See modifying contract of September 1, 1930.) (p. 116.) Other provisions of the contract of February 27, 1930, are found which were not pleaded and it is then found that the contract of February 27, 1930, "was modified by two later contracts entered into between said parties on May 8, 1930, and September 1, 1930 (p. 39), and that these contracts are "assets of respondent". (p. 39.) The amended petition had charged "that no consideration was or ever has been received by the respondent for said United States patents". The court found:

> "That the said contract of February 27th, 1930, and all of the transactions arising therefrom and in connection therewith, whereby said respondent and said Will H. Hays, Ambrose N.

Diehl and Roy T. Wise, had acquired *without adequate or any consideration* were *by respondent and said parties concealed* from the creditors of said corporation *and from its stockholders, other than Roy T. Wise;* that to effectuate said concealments said respondent and said Will H. Hays, Ambrose N. Diehl and Roy T. Wise, falsely represented *to said creditors and stockholders, that the said patents had been disposed of for the sum of $25,000.00; that in addition to the concealment of said contract and the transactions arising therefrom and in connection therewith, said respondent and said Will H. Hays, Ambrose N. Diehl and Roy T. Wise, further concealed from said shareholders and said creditors of respondent, any possible causes of action against Will H. Hays and/or Ambrose N. Diehl and/or Roy T. Wise, and/or against Wise Patent and Development Company arising out of said contract and/or for the setting aside of said assignment of said patents to Wise Patent and Development Company and/or for damages resulting from the fraudulent acts of said parties, Will H. Hays, Ambrose N. Diehl and Roy T. Wise, in acquiring and converting to their own use, the assets of respondent without adequate or any consideration therefor."* (pp. 39, 40.)

The above findings are supplemented by a further finding numbered VII, as follows:

"VII.

The court further finds that this entire case and the transactions above set forth, on the part of said respondent, and said Will H. Hays, Ambrose N. Diehl and Roy T. Wise, are tainted

with fraud and concealment *and warrant a full and complete investigation through the processes of the bankruptcy court.*" (pp. 41-42.)

The findings were prepared by the other side. No criticism is implied in this statement. These findings do show that the learned trial court, at the invitation of petitioners, construed their amended petition as charging that a conspiracy or fraud was practiced upon the corporation to get its patents and that the contract of February 27, 1930, was but a part of this fraud and that the rights resulting to the corporation were its valuable assets and that it was these rights which were fraudulently concealed; that it was not simply a case in which the corporation had taken a contract to which it was entitled because its property was used as the consideration therefor. The findings proceed on the theory that there was fraud not only in the transfer of the patents but also that there was fraud in concealing the deal involving the transfer of the patents. It is clear that the trial court based its order upon the lengthy finding as to fraudulent practices which were not alleged. The court's attention is called to Finding V, which reads as follows:

> "That all of the aforesaid acts of concealment of assets of the respondent, continued from the time of their original commission up to within four (4) months of the filing of the original and amended petitions herein, and the original and amended petitions herein were filed within four months from the discovery of the above mentioned acts of concealment of assets by respondent.
>
> That the aforesaid assets of respondent were concealed as aforesaid with the intent to hinder,

delay and defraud the creditors of respondent." (p. 41.)

The court's finding on the concealed bank deposit is Finding (b) of paragraph V, pp. 40, 41), as follows:

> "(b) That the said respondent through its President Roy T. Wise, during the months of June, July and August, 1931, caused to be sold and did sell certain tools, machinery and equipment belonging to said respondent to persons unknown; that respondent received the approximate sum of six hundred twenty ($612.00) dollars, from said sales; that said sum of six hundred twelve ($612.00) dollars *was an asset* of respondent, which on or about the month of August, 1931, was concealed by respondent depositing the same in the West Berkeley Branch of the Bank of America, Berkeley, California, in the name of one H. Jacobson, an employee of respondent." (pp. 40, 41.)

The court will thus note that the trial court does not find that this bank deposit "is" an asset of the respondent. In other words, the finding is consistent with the erroneous theory hereinbefore mentioned that there can be concealment without concealed property. The point here made should be considered at once for if we are wrong in saying there was no evidence of fraudulent concealment of any kind and no evidence of concealment within the four months period, the work of considering lengthy evidence on the other branch of the case is avoided. So we take up our Point I out of the usual course.

POINT I.

THERE WAS NO FRAUDULENT CONCEALMENT OF THE BANK DEPOSIT. THERE WAS NO CONCEALMENT OF SUCH PROPERTY WITHIN FOUR MONTHS OF THE FILING OF THE ORIGINAL PETITION OR WITHIN FOUR MONTHS OF THE FILING OF THE AMENDED PETITION.

Possibly it can be stated that if a corporation deposits money in the name of another person to prevent its being attached, there is a technical concealment with a view to hindering, delaying and defrauding creditors. We do not concede that such hiding of assets is an act of bankruptcy unless the intent is to defraud creditors. And clearly something more is required than merely proving that the depositing of the money in the name of another is with the view to preventing attachments. We do not concede that this is a departure from the secrecy and privacy with which any individual is entitled to transact his business. There was no admission and there was no proof that Roy T. Wise as president of the corporation, or any other officer of the corporation, handled the deposit as it was handled with a view to cheating or defrauding any creditor. There is secrecy in practically every preference. It was urged by the learned counsel for petitioners that concealment was a continuing offense. We pointed out the rule that concealment is not a continuing offense when the asset concealed has ceased to exist or has been disposed of by a preference or transfer. The learned trial judge adopted the theory of the other side.

The witness, F. W. Peters, was upon the stand and he was about to be questioned by counsel for peti-

tioners for the purpose of obtaining admissions from Roy T. Wise who had been the president of Wise Manufacturing Company as to this bank deposit of $605.00. (p. 75.) We interrupted to ask whether the facts could not be stipulated to. We stated that we had a letter from Miss Jacobson who was the H. Jacobson or Huldur Jacobson mentioned in the petition, showing her withdrawal of the final balance of the account in the West Berkeley Branch of Bank of America and her charging of this balance with a salary claim of approximately $350.00; that this letter was addressed to attorneys Clark, Nichols & Eltse, and that this letter claimed that she had this bill for unpaid secretarial services. We further stated that we had a letter from Mr. Sorrick, the Manager of the Berkeley Branch of the Bank of America, which showed the closing of this account in November, 1931. (p. 75.) Counsel asked to be shown this letter (p. 76) and stated that he was not interested in the letter from the lady "because I think that you should have her here". We stated that we could give the exact deposits; that we had the letter covering this from Mr. Sorrick, the bank manager. Counsel then stated that he would go ahead and make the stipulation that he was willing to make. The attorneys then stipulated that the account was opened in the name of Huldur Jacobson on June 25, 1931, the total deposits being $612.00; that the account was closed on November 23, 1931, by the withdrawal of the balance which existed at that time, namely, $430.00; that the funds that went into the account were derived from the sale of small tools belonging to the

corporation; that the funds were put into this account in the name of Huldur Jacobson to avoid their being attached by the creditors of the corporation.

The balance of the stipulation and evidence on this issue was as follows (pp. 77 to 81):

"Mr. Resleure. And will you further stipulate, as your answer indicates, that the object in putting this money in the name of Huldur Jacobsen was to prevent any of the creditors of the Wise Manufacturing Company ascertaining the existence of these funds and making possible attachment thereon?

Mr. Clark. Well, it was the usual practice of putting funds in there to avoid their being attached. We so stipulate; the funds put in the name of Huldur Jacobsen; deposits put in her name to avoid of it being attached by the creditors.

Mr. Resleure. And will you further stipulate that these funds were concealed from creditors and from all other persons by the respondent in this manner, having the account in somebody else's name?

Mr. Clark. Well, I think the Court can draw its conclusion that it was a practice perhaps to be condemned. I do not want to stipulate to that conclusion.

Mr. Resleure. All right.

Mr. Clark. Now, that I have stipulated to that, will you not stipulate that the account was closed, as indicated by that letter sent by Huldur Jacobsen?

Mr. Resleure. No, I am afraid I cannot go that far, much as I would like to return your courtesy. I would like to have Miss Jacobsen,

who is a former employee, here to cross-examine her as to what happened to these funds.

Mr. Clark. *Paid out all of them down to that point, under the direction of Mr. Wise.*

Mr. Resleure. *We will stipulate that the funds were paid down to $184 on November 28th, at the direction of Mr. Wise.*

Mr. Clark. That is right.

Mr. Resleure. That is what you want.

Mr. Clark. Yes; that is right, $184.45.

Mr. Resleure. Apparently this conflicts—But we will let our stipulation stand.

Mr. Clark. She was written to for the balance of the money, and she was then down at Turlock. Instead of sending the balance of the money,—$530,—and the bank records show it, she had the account transferred to herself at Turlock,—the balance of $530. She then sent a letter to Clark, Nichols & Eltse, reciting that she had withdrawn from the account $345.55 unpaid salary, salary earned prior to April 18, 1931, leaving a balance of $184.45. She enclosed the check to us for that amount. The bank records show she withdrew the $530 on the date indicated in the other letter from which you were reading——

Mr. Resleure (interrupting). $430——

Mr. Clark (interrupting). Well, that is a clerical mistake. May I correct that? That is just Mr. Sorrick's stenographer's clerical mistake.

Mr. Resleure. Yes, go ahead, stipulate it was $530.

Mr. Clark. Yes, $530.

Mr. Resleure. In my original stipulation—In other words, in the first stipulation that I narrated, the amount that I stated of $430, being the balance on hand, should have been $530, and

the mistake was due to a clerical error in the letter.

Mr. Clark. I think our stipulation is perhaps unfinished. *You stipulate the lady did withdraw the $530 as indicated by Mr. Sorrick, or do you want me to call him over here? It is useless.*

Mr. Resleure. *Yes, we will admit the $530 was withdrawn.*

Mr. Clark. By Huldur Jacobsen?

Mr. Resleure. All right; by Huldur Jacobsen.

Mr. Clark. And that she kept $345.50 of it, and remitted the balance to Clark, Nichols & Eltse. This letter shows it.

Mr. Resleure. Well, I think we are in hopeless confusion with the stipulation. The letter, as a matter of fact, shows she sent you a check for $184.45.

Mr. Clark. That is what I said.

Mr. Resleure. But she did not withdraw the entire $530.

Mr. Clark. No. Get this: The account was deposited in the West Berkeley Branch of the Bank of America. She was a clerk of some kind in the Wise Manufacturing Company. She moved to Turlock. When she was requested to remit the balance of this particular account which was deposited in her name, she saw a lawyer—she indicates in her last paragraph she had seen a lawyer—and the bank records show she called for $530 to be sent to the Bank of America, the branch at Turlock; and she then sent to us a statement showing that she had taken from the $530, $345.55, and she remitted to us the balance.

Mr. Resleure. *All right. We will stipulate to everything that Mr. Clark says, except we won't*

stipulate that the $184 went to pay attorneys' fees, and we won't stipulate that the $345.55 went to pay prior salary. You can testify, yourself, as to that.

Mr. Clark. I have been trying to aid you by stipulating to records. Do you want me to take the deposition of Huldur Jacobsen?

The Court. I think you gentlemen will be able to agree on that.

Mr. Clark. *She took the money, we never have been able to collect it.*

Mr. Resleure. *All right, we will agree to it.*

Mr. Resleure. *Yes.*

Mr. Clark. *At that time, November 28, 1931.*

Mr. Resleure. Well, let me see? Where is your other letter—*Yes, approximately that time.*

Mr. Clark. All right."

The witness Peters continued:

"I know that Mr. Wise told me the money (referring to the money mentioned in the foregoing stipulation) was deposited in Miss Jacobsen's name, *and he told me also that she had withdrawn the greater part of it to pay her salary.*"

Peters was their witness. This was their proof.

Concealment ceases to be an act of bankruptcy when the property concealed ceases to exist. This is evidenced by the rulings that where there is concealment in connection with the transfer made with a view to hindering, delaying or defrauding of creditors, the act of bankruptcy which the law permits a petitioner to rely upon is the transfer. The bank deposit here

was all used up and paid out in 1931. The original petition was filed March 30, 1933.

Citizens Bank v. W. C. DePauw Co., 105 Fed. 926;

Revis v. U. S., 9 F. (2d) 496.

It is not pretended that Wise pocketed any of the bank deposit and that he was holding it within four months of the filing of the petition. The law does not mean that a creditor can have a corporation adjudged bankrupt upon a petition filed in the year 1934, if the creditor discovers that in 1924, the corporation deposited in the name of a third person and with a view to preventing attachments, the sum of $100.00, and later in the year 1924, lost the money or withdrew it and used it in its business.

It is of course conceded that concealment is a continuing offense and that it continues up to the time of discovery.

Citizens Bank v. W. C. DePauw Co., 105 Fed. 926;

In re Havens, 255 Fed. 478.

But this does not mean that the act can continue forever without a subject matter to which it relates. *As we have indicated, the findings which were prepared by the other side are simply silent on allegation and denial that the money deposited "is" the property of the corporation.* The finding is that the $612.00 *"was an asset"* concealed *"on or about the month of August 1931"*. (pp. 40, 41.)

STATEMENT OF CASE WITH RESPECT TO CONCEALMENT OF FRAUD IN TRANSFER OF PATENTS.

We shall first refer to condition of Wise Manufacturing Company in 1929 and next to the facts with which it is claimed the alleged concealment occurred.

The court will note that many of these facts were developed on cross-examination. After endeavoring to show a fraudulent obtaining of the company's patents and that Wise pretended they had been sold for $25,000.00 and had thereby accomplished concealment of the fraud, petitioners confined their case to showing that Mr. F. B. Cerini, the attorney, who filed the original petition (p. 5) for the petitioning creditors did not know of the existence of the contract of February 27, 1930 "until the first week in March 1933" (p. 82, Cerini) and that the making of this contract was ascertained at this late date only as the result of visits, beginning in October, 1932, to Wise's house in Berkeley by attorney F. W. Peters, who had been employed by Franklin Palm and certain other preferred stockholders of Standard Die & Tool Company (which owned most of the stock of Wise Manufacturing Company) to investigate a case which Palm had brought for the preferred stockholders and "report back to the preferred stockholders". (p. 43, Peters.)

It is claimed that the concealment of the fraud practiced and of the contract of February 27, 1930, is made out by proof of admissions in conversations which were had with Wise and by proof of conduct of Wise on the occasion of these visits, taken in connection with certain facts which were put before the court in the direct

testimony of witnesses Peters, Palm, White and Olin. The cross-examination and records offered by appellant placed before the court additional facts. It will aid the court if these facts are rearranged and presented in a chronological order. And this we shall endeavor to do. But we will state here our additional points so that the court may have them in mind in stating the case as presented by the evidence.

APPELLANT'S ADDITIONAL POINTS.

Appellant makes the following additional points for reversal:

POINT II.

THERE WAS NO CONCEALMENT WITHIN THE FOUR MONTHS PERIOD OF THE ALLEGED FRAUDULENT TRANSACTIONS OF WHICH THE CONTRACT OF FEBRUARY 27, 1930, IS ALLEGED TO BE A PART. THE COURT WILL NOTE THAT AT THE INVITATION OF PETITIONERS, THE TRIAL COURT TREATED THE AMENDED PETITION AS CHARGING AND PETITIONERS PRESENTED THE CASE ON THE THEORY THAT THE CONTRACT OF FEBRUARY 27, 1930, WAS A PART OF A FRAUDULENT CONSPIRACY AGAINST THE CORPORATION AND THAT IT DID NOT SIMPLY REPRESENT AN ASSET FOR WHICH IT HAD PROVIDED THE CONSIDERATION AND WITH WHICH IT WAS SATISFIED AND WITH WHICH ITS CREDITORS HAD TO BE SATISFIED. THE FINDINGS ARE, IN EFFECT, THAT THE COMPANY'S PATENTS, WHICH WERE ALLEGED TO BE THE ONLY PROPERTY OF SUBSTANTIAL VALUE WHICH THE CORPORATION OWNED, WERE FRAUDULENTLY SUBJECTED TO

THE ARRANGEMENT REPRESENTED IN PART BY THE CONTRACT OF FEBRUARY 27, 1930, AND WERE FRAUDULENTLY PLACED IN WISE PATENT AND DEVELOPMENT COMPANY; THAT THIS HANDLING OF THE PATENTS HAD CAUSED GREAT DAMAGE AND THAT THE LEGAL SITUATION IS SUCH AS THAT, (A) POSSIBLY THE CONTRACT MAY STAND AS A CORPORATE CONTRACT, WHOLLY OR IN PART, AND DAMAGES BE RECOVERED, OR (B) THE CONTRACT MAY BE DISREGARDED AND A CONVERSION CAN BE CLAIMED, OR (C) IF THE CORPORATION SO DESIRES, A RESCISSION CAN BE CLAIMED AND THAT THESE TRANSACTIONS WERE FRAUDULENTLY CONCEALED FROM SHAREHOLDERS AND CREDITORS. THUS AT THE INVITATION OF PETITIONERS, THE TRIAL COURT CONSTRUED THE AMENDED PETITION AS CHARGING A FRAUDULENT DEALING WITH THE PROPERTY OF THE CORPORATION AND THAT THE CONTRACT OF FEBRUARY 27, 1930, WAS BUT PART OF THE PLAN. WITHOUT CONCEDING THE FRAUD OCCURRED, IT IS CLEAR THAT IF IT DID OCCUR, DISCOVERY OCCURRED LONG PRIOR TO FOUR MONTHS BEFORE THE FILING OF THE ORIGINAL PETITION.

POINT III.

THE FINDINGS ARE OUTSIDE THE ALLEGATIONS OF THE AMENDED PETITION. THE EVIDENCE FAILED TO SHOW THE CONTRACT OF FEBRUARY 27, 1930, WAS THE CONTRACT BETWEEN WISE, HAYS AND DIEHL. IT HAD BEEN VARIED IN SUBSTANTIAL PARTICULARS BY THE TWO LATER CONTRACTS OF MAY 8, 1930, AND SEPTEMBER 1, 1930. THE ONLY POSSIBLE THEORY UNDER WHICH THOSE CONTRACTS, WHICH WERE KNOWN TO PETITIONERS, COULD BE OMITTED FROM THE PETITION WAS THAT THE PETITION CHARGED

AMBIGUOUSLY, OR OTHERWISE, A SCHEME OF WHICH THEY WERE BUT AN INCIDENT TO BE DEVELOPED IN PROOF. AT LEAST THE QUESTION OF DISCOVERY SHOULD NOT BE CONFINED TO THE QUESTION AS TO WHEN ATTORNEY CERINI SAW THE CONTRACT OF FEBRUARY 27, 1930, WHEN PETITIONERS' THEORY IS THAT IT IS BUT A PART OF THE FRAUDULENT PLAN OF MISAPPROPRIATING THE PATENTS.

FURTHER STATEMENT OF THE CASE AS TO POINTS I AND II.

The pleadings evidence and the recitals in the contracts introduced in evidence showed that prior to 1930, there were two California corporations, the Standard Die & Tool Company and Wise Manufacturing Company, having headquarters in Berkeley. The former company owned about ninety-five per cent of the stock in the latter company and Roy T. Wise owned two-thirds of the stock in the holding company.

Roy T. Wise was the president of and he controlled both companies.

The Standard Die & Tool Company was inactive. The operating company was the Wise Manufacturing Company.

The stock in Standard Die & Tool Company was both common and preferred; in the Wise Manufacturing Company the stock was all common stock. The stock ownership in the two companies was as follows:

Standard Die & Tool Company.

Roy T. Wise	660	shares, common.
Roy T. Wise	5	" , preferred.
Others	34	" , common.
Others	258	" , preferred.

Wise Manufacturing Company. (All common.)

Standard Die & Tool Company	4670 shares.
Others	216 "
Subscribed for but not fully paid	55 "

By the stock purchase plan of contract of the contract of February 27, 1930, options to acquire all the foregoing stock, excepting that owned by Wise and the item of 4670 shares, were to be exercised and the existing creditors of the Wise Manufacturing Company were to be paid. This plan was not fully carried out. About 195 shares of the preferred stock held by others in Standard Die & Tool Company was not taken up and this fact may properly be said to be one of the causes of this action. (The figure 195 shares may be slightly erroneous. The estimate is made up as follows: First, by taking the 80 shares of stock held by those who signed the trust agreement hereinafter referred to (pp. 175, 176) and, next, by taking the statement of the witness Peters as to the stock held by preferred stockholders who were formerly represented by attorney Waddell and who are now represented by Mr. Peters. This stock amounted to $11,500.00. It would make 115 shares. (p. 44.) As the funds ran short, the preferred stock in Standard Die & Tool Company was taken up only in those cases where it was held by a holder of common stock in the company. Assuming that the outstanding stock was all purchased by Wise, it will be observed that over 81% of the stock in the companies became Wise stock.)

Prior to January 1, 1930, Wise Manufacturing Company was heavily indebted. It had a first deed of trust

on its plant for $18,000.00. This deed of trust was foreclosed in the year 1931. The witness, Peters, page 120, explains his ascertaining this $18,000.00 deed of trust. The original petition filed herein, pages 4 and 5, recites that all the company's property has been sold out under security instruments. Olin testified at page 168 that the $18,000.00 deed of trust was unpaid when he signed the $25,000.00 second deed of trust with chattel mortgage provisions, dated May 16, 1930. Peters testified, at page 120, that the company "had no assets whatever other than these patents". In addition the Wise Manufacturing Company was indebted in the sum of $25,000.00 on open accounts or unsecured notes and it will be observed that the so-called fraudulent conspiracy had for its first purpose the paying off of the indebtedness last mentioned.

December 31, 1929.—Company adopted a resolution that it was in distress financially and Wise was trying to raise money to pay off these creditors. (p. 162, Peters.)

January 27, 1930.—Company adopted a resolution reading as follows (p. 103):

> "President Wise discussed conference with Mr. Will Hays on his trip to Los Angeles January 21st to 25th. During conference Mr. Hays telephoned A. N. Diehl, Vice President of the Carnegie Steel Company of Pittsburgh and made a definite appointment for Mr. Wise to discuss the possibility of refinancing, License to Manufacture, or the probability of outright sale. Mr. Will Hays is to act as our counsel in this matter—no definite plan having as yet been determined. At Mr. Will

Hays' suggestion, Mr. Wise is to take 5 HP Westinghouse motor and transmission, together with pony brake, and demonstrate it to concerns as recommended by Mr. Hays.

Motion was made by Mrs. Wise, seconded by Mr. Olin, to give our attorney James E. Waddell authority to use his best judgment in the settlement of our account with the Kidelite Company of Lewiston, Idaho."

February 27, 1930.—Date of contract pleaded. This contract recited that Wise, Diehl and Hays were the parties; that Wise had patented certain devices for applying transmission speeds to induction motors, the patent numbers being given; that Wise had caused the organization of the two California corporations, and that the patents were lodged in Wise Manufacturing Company; that the stock in the two corporations was held as hereinbefore set out; that Wise believes that it will be for the best interest of Wise Manufacturing Company and its stockholders to sell the patents; that Wise had approached Diehl and Hays for assistance in the promotion of the patents; that they had agreed to render this assistance; that Wise Manufacturing Company has expended $50,000.00 in the development of the patents; that Wise controlled the California corporations and can cause the carrying out of the terms of agreement; that a corporation shall be formed under the laws of Delaware called Wise Patent and Development Company which shall take over the patents; that the capital stock of the company shall be 1200 shares; that as to 1000 shares of this stock, one-third of it shall go

to Wise and two-thirds of it to Diehl and Hays, and that 200 shares shall be left in the treasury, it being specified that a certain use may be made of the 200 shares; that Wise will cause the patents to be transferred to the new company; that Diehl and Hays will advance expenses for incorporating the new company. The powers of the new company are provided for and in Par. 7. (pp. 57, 58.) It is provided that after the new company gets the patents it shall develop, market and license the same, and that "from surplus accumulating over the expense of operating" the new company, payment of $75,000.00 will be made to Wise and the California companies for expenditures to date in connection with the development of the patents, together with substantial addition; that it is understood that neither the physical properties nor any of the stock of Wise Manufacturing Company shall be transferred to the new company. In Par. 9 (p. 59), Wise agrees to proceed immediately to procure ninety day options on all of the preferred and common stock of Standard Die & Tool Company and ninety day options on all of the stock of Wise Manufacturing Company, in order to have entire ownership of Wise Manufacturing Company at the time of the transfer of the patents arranged for. It is provided that the consideration for the transfer will be the $75,000.00 and "the issuance of all or any part of the stock as the parties of the second part may elect to the party of the first part, or to the Wise Manufacturing Company, with the understanding that such reassignment of such stock of Wise Patent and Development Company will be

made as that ownership of such stock shall be as outlined in Article 2". (p. 60.)

March 10, 1930.—Company adopted a resolution providing for employment of auditors to prepare a complete list of company's debts. A list was prepared and left at the bank. (p. 104, Peters.) These claims were paid off and certain stock in both companies was taken up through escrow 167 at Bank of America, Berkeley, California. (p. 163, Olin.) The money came from Hays, acting for Wise Patent and Development Company.

March 11, 1930.—This escrow was arranged for through a letter sent by Ralph R. Eltse of the firm of Clark, Nichols & Eltse to First Berkeley Branch, Bank of America. (pp. 130, 131.) Douglas F. Scott, an officer of the bank, testified to this fact and in his testimony he explained that the bank was not permitted to give out any information in regard to the source of this money received by the bank or as to the terms of any contract under which it was received. The witness testified (pp. 131, 132, Scott):

> "The first correspondence we had in connection with the escrow in arranging the agreement was a letter from Mr. Ralph R. Eltse dated March 11, 1930. This letter of March 11, 1930, was received in evidence as Petitioners' Exhibit No. 7. In substance it directed the action of the bank in paying out the moneys which it received to the creditors and to the stockholders. It contained the statement 'We solicit confidence as to all matters contained in this letter.' The letter was signed by Ralph R. Eltse.

Q. Referring to the last statement in the letter, 'We solicit confidence as to all matters contained in this letter'; that came to your attention, did it?

A. It did.

Q. And you observed confidence in regard to that escrow?

A. We did."

The next resolution of the directors of the company, which resolution was signed by one of the petitioning creditors, E. W. Olin, shows an arrangement for borrowing the sums paid to the creditors amounting to $25,000.00. The resolution, dated April 11, 1930, read (p. 105):

"Director Pansy E. Wise read a letter received from Mr. Roy T. Wise, President of this Company, wherein Mr. Wise requested authorization to negotiate in the name, and for the benefit of the corporation, a loan of $25,000 the said sum to be used to satisfy current claims of creditors of this corporation pending sale of corporate assets to Messrs. A. N. Diehl, Will Hays, et al.

It appears from Mr. Wise's letter that some time might elapse before the validation and check-up of patents of The Wise Manufacturing Company involved in the sale.

A resolution was passed, a copy of which is attached hereto and made a part hereof, authorizing the President and Secretary in the name of the Corporation and under the corporate seal to execute a promissory note in the principal sum of $25,000, bearing interest at the rate of not to exceed 8% per annum.

There being no other business before the meeting, the same was on motion made, seconded and carried declared duly adjourned.

ROY T. WISE
President

E. W. OLIN
Secretary"

May 5, 1930.—Standard Die & Tool Company adopted a resolution authorizing the transfer of the patents involved to Wise Patent and Development Company, the Delaware corporation. (pp. 108, 109.)

May 5, 1930.—Standard Die & Tool Company assigned to *Wise Patent and Development Company* the patents and rights to patents described in the contract of February 27, 1930. *This transfer was recorded on May 22, 1930.* (p. 169.)

(It should be stated that the evidence did not show that Wise Manufacturing Company made any transfer of patents to Wise Patent and Development Company. It had been supposed that Wise Manufacturing Company had received a transfer of the patents for stock issued to Standard Die & Tool Company. While the Wise Manufacturing Company owned the patents, the transfer to Wise Patent and Development Company was made directly from Standard Die & Tool Company.)

May 8, 1930.—Contract of February 27, 1930, modified. (p. 109.) The modification recites that with the consent of the parties and since the contract of February 27, 1930, was made, the Delaware corporation has been formed and that its stock is 2500 shares of common stock of no par value and 1000 shares of pre-

ferred stock of the par value of $100.00 per share. (p. 110.) It was provided that 25 shares of the common stock should be issued equally to the three parties as directors and that in addition, each of them should receive 458-1/3 shares and that 200 shares of this stock should be set aside for the special use mentioned in the original contract, provided that all of such 1475 shares of common stock should be issued fully paid and non-assessable in exchange for the patents. (p. 112.) Par. C of the modification (p. 112) provided that no part of the $75,000.00 was to be paid until the parties of the second part, Diehl and Hays, had been reimbursed for advancements made by said parties for the account of Wise Patent and Development Company. Par. D provided that the 1000 shares of preferred stock would be sold as treasury stock at $95.00 per share (p. 113) and that from the proceeds of the sale of this stock the new company would loan to Wise not exceeding $75,000.00 and take as collateral security his stock in the California corporations together with all their assets, and that Wise will further deliver as security his stock in the new corporations. (pp. 113, 114.) It was next provided that in the event of the loan by the new company, Wise shall use the funds in retiring the obligations of the California corporations and in the purchase of the stock of said corporations. (p. 114.) It was also agreed that preferred stock dividends should constitute a part of the expense of operating the new company before anything would be paid on the original $75,000.00 promised. (pp. 113, 114.)

May 8, 1930.—Wise made a transfer of certain patents and patent rights to Wise Patent and Development Company. This was recorded in the Patent Office on May 22, 1930. (p. 169.)

Prior to May, 1930, and at the direction of Wise, options were procured from the stockholders of the Wise Manufacturing Company and the Standard Die & Tool Company whereby M. R. Gilbert or her assignee was given the privilege of purchasing the outstanding stock of these companies. These options were deposited at the First Berkeley Branch of Bank of America in said escrow No. 167. (The options did not cover the Wise stock.)

May —, 1930.—Extensions of these options were requested. (pp. 66, 67.) A circular letter was sent by Eltse to all of the stockholders to obtain these extensions. In this letter it was stated that details had not been completed in connection with the obtaining of advances to be secured from eastern capitalists *for the purpose of liquidating the present outstanding claims of creditors and for the purpose of providing funds to take up the stock under the options. It was stated that the parties making the advances would not close until they had made a thorough examination of the corporations and their assets including the patents and patent applications,* and that approximately ninety days would be required before the patents could possibly be issued on the applications. That the lenders were carefully checking the patent records at Washington. The court will note that this letter certainly suggested to every stockholder to whom it was issued that a con-

tract of some kind was being made whereby the California companies were to be divested of all of their interests in the patents and as is herein explained, it was a condition of the escrow under which the stock was to be taken up that the terms of the contract under which Wise was getting the money were not to be disclosed. At this stage, if stockholders were being defrauded, it was an invited kind of fraud—payment in full for stock in a corporation very badly in debt. Selling the stock meant selling the patents. And how was a creditor to be hurt who was paid in full? The Eltse letter stated:

> "(b). Details have not yet been completed in connection with advances being secured from eastern capitalists, proceeds of which are to be used in liquidating present outstanding creditors' claims and in providing funds to the optionee with which to take up the stock under the options. The parties making the advances will not close *until they have made a thorough examination of the corporations and assets,* including *the patents and applications for patents.* Patents on several of the applications have not yet been issued, and approximately ninety days will be required before the patents can possibly be issued on the applications. The lenders are carefully checking the patent records at Washington.
>
> Unless the requested extension is granted to the optionee it is doubtful if the creditors' claims can be liquidated and it is feared the creditors will take precipitate action which will mean the stockholders will suffer loss.
>
> You are assured and advised that no more money is to be obtained than is necessary to

liquidate the outstanding creditors' claims and to take up the options for the purchase of the stock at its par value.

We solicit your cooperation by the prompt execution and return of the enclosed extension of option." (p. 67.)

It was stipulated that Mr. Sorrick, manager of the First Berkeley Branch of Bank of America, where the escrow was being carried out, asked Eltse as to whether information as to the terms of the contract could be passed out and "Mr. Eltse stated that it was one of the conditions of this payoff as provided with this cash, that the terms of the contract and the parties were not to be disclosed." (pp. 132, 133.) So it is clear that if any creditors or any stockholders were being embarrassed in taking pay at the bank, they were perfectly willing to waive any right that they might have had to a full disclosure as to the terms of the contract which Wise had made. The plan fell down not because they were all not glad to take the money but because the cash advances stopped. *And that occurred in 1930.*

May 26, 1930.—Directors of Wise Manufacturing Company adopted a resolution providing that the company and Standard Die & Tool Company should borrow from Alonzo C. Owens from $25,000.00 to $75,000.00 and secure the payment of the same by a security instrument covering the real and personal property of the company. This resolution was certified to by one of the petitioning creditors as secretary of Wise Manufacturing Company, to-wit, E. W. Olin. (pp. 49, 50.)

May 16, 1930.—The company executed its note for $25,000.00 and its deed of trust with chattel mortgage provisions to Alonzo C. Owens, which security instrument covered the company's real and personal property. (p. 167.) These instruments were signed by E. W. Olin as secretary for the company.

May 27, 1930.—Wise Patent and Development Company sent a check for $25,000.00 to the First Berkeley Branch of Bank of America to be paid out under escrow No. 167, which was the escrow created to pay all of the existing debts as listed by the accountant, Van Dine. (p. 130, Scott.) Lacking a few dollars, the whole of this money was paid out to these creditors. (p. 130, Scott.) The check was signed by Will H. Hays.

(The claims involved in this suit originated after these creditors were paid off.)

June 9, 1930.—Hays sent to the same escrow $1600.00 to be used in taking up the stock of Wm. Roberts and H. G. White in Standard Die & Tool Company. (p. 130, Scott.)

September 1, 1930.—Contract of February 27, 1930, further modified. (p. 116.) This contract specifically provided that the provisions of the agreements of February 27, 1930, and of May 8, 1930, *for the payment of $75,000.00 to the California corporations was cancelled.* In paragraph 2 this modification recited that the new company had made a contract with Westinghouse Electric & Manufacturing Company, under the provisions of which the Westinghouse Electric &

Manufacturing Company had paid the new company $10,000.00 and was given the right to acquire an exclusive license to manufacture under the patents for the sum of $25,000.00, to be paid; that Wise shall receive the $10,000.00 and that if any of the $25,000.00 is paid, Wise shall receive the payment, but that these payments shall be credited on sums owing to Diehl and Hays, or to Wise Patent and Development Company, or to Alonzo C. Owens of Sullivan, Indiana, but that said credits should not be given until such time as payments would have been due to Wise under the two prior contracts had this agreement not been made and until liability of the three parties has terminated on a $40,000.00 note given to Westinghouse Electric & Manufacturing Company on August 30, 1930. (p. 119.)

September 2, 1930.—Hays sent an additional $16,-623.02 to the bank to be used in escrow No. 167 to exercise the options to take up more of the common stock of Standard Die & Tool Company. (p. 131, Scott.)

September 11, 1930.—An additional $1100.00 was deposited in the escrow to take up the stock of Dubendorf and Wilke. (p. 131, Scott.)

September 13, 1930.—An additional $1000.00 was sent to the escrow to take up the stock of J. J. Earle. (p. 132, Scott.)

As is next shown by the testimony of Halsey J. White, who was called as a witness by petitioners, it was thoroughly understood that Wise, who was directing the whole process of paying off these creditors and

the taking up of this stock, refused to give out what he was getting or the terms of the contract under which the money was being provided. *White, who had interested various people in the corporations and who actually undertook to act for several of the stockholders, exacted of Wise as the price of his remaining silent $200.00 a share for his stock instead of $100.00 a share, which was paid to and accepted by the other holders of common stock in Standard Die & Tool Company.* He told Wise that he was not getting information as to the contract which was being made for the disposal of the patents, and he explained *that he understood Wise was getting $1000.00 a month as an employee of some sort and that he proposed to block the deal unless they paid him $200.00 a share.* This man who acted for others was an officer in the investment department of the bank (p. 146) and it would seem to be absurd to say that he did not know Wise, the president, was not making a contract with the company's patents which provided an interest in his favor. We quote Mr. White's testimony, directing the court's attention to the fact that it relates *to a period almost three years before the petition in this case was filed* (pp. 148, 150):

> "I received for my stock the equivalent of $200.00 a share. That was paid me as testified by Mr. Scott yesterday, coming from Mr. Hays in the form of a check for $1600.00, $1000.00 of which was used to take up my stock. When I asked Wise what had become of the patent and what consideration if any there was, he just could not give me the details. I asked him what the

status of the company would be and its patent and he made no answer. I questioned him several times in this regard, always with the same result. At one time he stated that he was not at liberty to disclose the information or something of that sort."

Cross-Examination of Witness, White.

"It was approximately June, 1930, when I received my money for my stock. Some of the preferred stock was taken up from stockholders who also held common stock. Practically all of the preferred stock was not taken up. Then these preferred stockholders began to complain and among them was Mr. McMahon and other stockholders with whom I was acquainted. There were numerous complaints. I complained very much myself at the way it was being handled. I told Mr. Wise that because of the fact that he would not disclose the facts of his deal, I thought it was unfair to the stockholders, both preferred and common. The set price was $100.00 a share. To my knowledge no one ever asked me, and I never disclosed to anyone that I got more than the $100.00 a share. To my knowledge I am the only one that got more than $100.00 a share. My position there at the bank was agent of American Investment Company affiliated with the Bank of America." The witness was asked by Mr. Clark if one of the factors that contributed to his being able to get $200.00 a share for his stock instead of $100.00 was that by reason of his position in the bank he knew what was going on. The witness replied that there was a great deal going on at the bank that he had no access to.

Q. And of course you knew the patents were being transferred?

A. Oh, no.

Q. You knew that someone was putting up a lot of money there at the bank didn't you?

A. *It was my supposition that a deal was being made for Mr. Wise* who, it was reported, was receiving $1000.00 a month salary. I knew that a great deal of money was being put up there in the bank and that it was coming from Mr. Hays. Although I was an employee there in the bank, I had no access to these escrow files so as to know that the money was coming from Mr. Hays nor did Mr. Wise tell me that the money was coming from Mr. Hays. The final information I had on that subject came at a time when I by chance saw Mr. Hays's check for $25,000.00. I could not say how long after the check arrived it was that I saw it. I did not *at first* hear of Mr. Hays's connection. I presumed this money would go out to the great batch of creditors very shortly after I saw the check although I saw nothing of the disposition.

Q. You were a common stockholder in this company and you knew that the creditors were filing into the bank and they were getting their money?

A. I assumed that they would get their money.

Q. *It was common information then that at the time these contracts were being made, that instead of defrauding the creditors, all the creditors were going to be paid?*

A. *I believe that is correct.* No list of creditors was ever submitted to the common stockholders to show whether these creditors were paid off at that time. I complained to Wise about his with-

> holding information about the transaction between himself and the other parties interested and stated that in the absence of information *I felt that I would rather not see the deal go through,* that I preferred to hold my common stock as I believed that it had a value in excess of $100.00 a share."

So it was clear to everyone over two years before this proceeding was begun that Wise, though named the president, took a position adverse to the corporation, repudiated his trust: "It was my supposition that a deal was being made for Mr. Wise", etc. In acting adversely to the corporation, he was no more the corporation than a stranger would have been—in the absence of proof that the corporation ratified his acts. Petitioners here contend and obtained findings which are the very opposite of that.

The Wise Manufacturing Company continued to do business at its place of business in Berkeley, California, and it incurred additional debts and it again became in need of funds.

Alonzo C. Owens of the office of Hays & Hays held the deed of trust with chattel mortgage provisions securing the $25,000.00 note and he was requested to release his chattel mortgage so that another first chattel mortgage could be put on the personal property in order to raise $5000.00 to meet additional creditors' claims. The exact date in 1930 when this waiver was requested and was granted does not appear, but the fact that the waiver was requested and that the request was granted by Owens appears at two places in the transcript. (See pages 122 and 165.) But the money could not be obtained.

Counsel may urge that Hays, Wise and Diehl were tainted with fraud but surely at this stage, Hays and Diehl, acting through Owens were not altogether arch criminals towards these creditors.

December 26, 1930.—The stockholders (as they had become) in the Wise Manufacturing Company signed an approval of the transfer of the patents to Wise Patent and Development Company. This appeared on the minute books of the two companies. (p. 46, Peters.)

Part of the preferred stock in Standard Die & Tool Company was not taken up and these stockholders claimed they had been wronged.

April 3, 1931.—Wise tried to appease the preferred stockholders, who were bitterly complaining that they had been defrauded, by tendering a declaration of trust to Bank of America and requesting the bank to hold the stock in the Wise Patent and Development Company, which he had obtained, in trust for the purpose of paying the par value of their stock to the preferred stockholders in Standard Die & Tool Company. The payment intended was to be made to those who were not paid through the escrow. (pp. 133, 134 and 135 to 145.) W. P. Woolsey accepted the position of trustee under this declaration of trust, and about forty per cent of the preferred shareholders whose stock was not taken up accepted it. (Signatures, pp. 175, 176.)

Obviously this transaction showed that the shareholders claimed that Wise had wronged the company

by taking its assets while president. On no other theory was there a claim to be adjusted.

April 29, 1931.—Olin, former secretary of the company, and Sites, two of the petitioners herein sue the company. (p. 168.)

May 1, 1931.—Wise Manufacturing Company's right to do business in California was suspended for failure to pay its state franchise tax. (p. 45.)

June 5, 1931.—Frank L. Hain, substituted trustee under the deed of trust with chattel mortgage provisions that had been given to Alonzo H. Owens to secure $25,000.00, foreclosed said instrument and the mortgaged property was sold to Alonzo H. Owens for $12,000.00. (Transfer, p. 170.)

From that day the Wise Manufacturing Company did no business.

(The real property had already been sold out under the $18,000.00 deed of trust.)

November 30, 1931.—Franklin C. Palm for himself and other preferred stockholders in Standard Die & Tool Company brought suit against Hays, Diehl and Wise to set aside the whole deal with the Wise Patent and Development Company alleging that these three men had obtained in equal shares all the stock of the latter company and

> "That the said transfer of the said patents, business, and assets of said Standard Die & Tool Company and said Wise Manufacturing Company dated on or about March 5th, 1930, *was and is a fraud* upon the preferred stockholders named in Paragraph 9 and upon plaintiff." (p. 93)

January or February, 1932.—Olin and Sites obtained judgments in the cases which they brought against the corporation. (p. 168.) These judgments are pleaded in the petition. (p. 8.)

The attorney for these parties was Mr. Waddell (p. 168) who had been a director of and attorney for Wise Manufacturing Company and the man who prepared its minutes. (p. 169, bottom of page.)

We set out the assignment of errors relied on and proceed with the argument of Points II and III.

Assignment of Errors.

"4. The court erred in finding and determining that respondent concealed an asset or item of property of respondent in that it concealed the so-called contract of February 27, 1930, the fact appearing that the said contract was changed in vital particulars and superseded by later written contracts executed by the same parties, with respect to the same subject matter.

7. The court erred in finding and determining that concealment from the creditors of respondent of the contract mentioned in Paragraph V(a) of the amended petition occurred within four months prior to filing of the original petition on March 30, 1933.

8. (Repetition except reference is to filing amended petition.)

9. The court erred in refusing to find and hold that the contract of February 27, 1930, mentioned in Paragraph V(a) of the amended petition was not the contract under which the patents therein referred to were transferred and held.

10. The court erred in refusing to hold and determine that the petitioning creditors did have knowledge of the making and existence of the contracts which represented the arrangements under which the patents referred to were transferred more than four months prior to March 30, 1933.

11. The court erred in finding and determining that respondent could be adjudicated a bankrupt and in adjudicating respondent a bankrupt for concealment of property or for wrongs other than those charged in Paragraphs V(a) and V(b) of the amended petition.

13. The court erred in finding acts of concealment and wrongdoing on the part of the respondent which were entirely outside of what was alleged in the amended petition, and in basing the order of adjudication thereon. Nothing but the contract of February 23, 1930, is referred to in Paragraph V(a). The evidence showed that that contract did not exist, that it did not represent the arrangement under which the patents were held. The allegation that said contract was an asset of the respondent was untrue.

14. The court erred in finding and determining that concealment from the creditors of respondent of the property mentioned in Paragraph V(b) of the amended petition did, in fact occur.

15. The court erred in finding and determining that concealment from the creditors of respondent of the contract mentioned in Paragraph V(b) of the amended petition occurred within four months prior to the filing of the original petition of March 30, 1933.

16. (Repetition excepting reference is to time of filing amended petition.)

17. The court erred in refusing to find and to hold that over a year prior to the filing of the amended petition the bank deposit and moneys referred to were used up and ceased to be an asset of the respondent corporation.

18. The court erred in making an order adjudicating respondent a bankrupt.

19. The court erred in finding and determining that respondent had concealed its property from its creditors with a view to hinder, delay and defraud them and within four months prior to the time of filing of the original petition herein on March 30, 1933.

20. (Repetition except reference is to filing of amended petition.)

21. The court erred in overruling the preliminary objections made to the taking of testimony as to declarations or statements made by Roy T. Wise, upon the ground that the said Roy T. Wise did not have authority to speak for or bind the respondent by his statements or admissions. The objections referred to were, with the consent of the court, made at the very outset of the taking of the testimony of the witness Peters. The objections were repeated from time to time, and they were all overruled. The objections referred to were those objections which went to the whole of the testimony of the witnesses to the declarations or statements of Roy T. Wise, offered for the purpose of showing the respondent had concealed the execution of the contracts under which the patents referred to were transferred." (pp. 182, 183, 184, and 185.)

POINT II.

This point briefly is that if the fraud claimed occurred, it was not concealed to a point of time within four months of the filing of either the original petition or the amended petition. (See page 18.)

Obviously, if the amount of money had been obtained which it was expected would be obtained, all the creditors of the Wise Manufacturing Company would have been paid off and all of the stock of the two California Companies would have been taken up. That, apparently, was the intention at the outset. But the plan broke down and only such of the preferred stock in the Standard Die & Tool Company as was held by stockholders who held common stock was finally taken up through the escrow. This left about 195 shares of stock in Standard Die & Tool Company outstanding. That is about 20% of that company and that company owned about 94% of the Wise Manufacturing Company. There was thus a failure to purchase about 19% of the Wise Manufacturing Company.

It was testified at length by the witness, Peters, that Wise and Hays and Diehl had finally figured that it would not be necessary to take up the preferred stock of Standard Die & Tool Company because the preferred stock had no voting rights. Douglas Scott, who for the bank had charge of escrow No. 167, explained that the preferred stock was not all taken up and he explained that prior to April 1931, these preferred stockholders were complaining and that in April 1931, Wise had sought to satisfy

them by executing a declaration of trust covering his stock in Wise Patent and Development Company and that the bank had refused to act as trustee. Scott testified (pp. 133, 134):

> "I remember that in April 1931 there was tendered to the bank a declaration of trust, executed by Roy T. Wise. I have a letter with me, dated April 3, 1931, sent by Clark, Nicholas & Eltse. At that time there had been grumbling by the preferred stockholders, who had not gotten their money. I presume they had anticipated they were going to get their money. I remember there were more options put up than were taken up —a lot more. These preferred stockholders were complaining, and they were inquiring of me, because they had not gotten their money. This escrow was completed in the year 1930 as far as paying out the money was concerned. It was not completed in so far as taking up all of the options were concerned, a certain number of the options for the stock had been held until the period of time had more than expired and the stockholders were requested to withdraw their stock. All of the common stock of the Wise Manufacturing Company was taken up and paid off, excepting common stock owned by the Standard Die and Tool Company, the old parent company. I cannot answer for sure that all of the common stock of the Standard Die and Tool Company was taken up but I think it was all taken up. In addition some of the preferred stock of the Standard Die and Tool Company was taken up. We had a long list of stockholders who were perfectly willing to take their money if it was paid by Mr. Hays. However, he quit sending money so the options could not be exercised. This

all occurred in 1930. I know that there was discontent on the part of the stockholders who had not received their money.

Q. And *there was discontent, also, wasn't there, about what Wise was getting out of it?* Wasn't that *pretty noisily* kicked about in Berkeley and in the bank?

A. *Yes, it was, yes.*

Q. *It was plenty strong that Mr. Wise had some sort of a contract in which he was getting some sort of a nice profit out of it, wasn't that said?*

A. *I cannot remember it was actually said, but it was intimated.*

Q. *Rather strongly from these stockholders, in 1930?*

A. *Yes.*"

Peters in his investigation questioned Wise as to why the balance of this preferred stock was not taken up and Peters testified that Wise had said that they had been of the opinion that this stock had no voting rights and that it would not be necessary to acquire this stock and he also testified that Wise had explained that only $40,000.00 had been obtained from the Westinghouse Company in a deal with that company whereby the latter company took a license under the patents. This money, as shown by the testimony of Peters and by the letter of Alonzo H. Owens to Wise (our Exhibit B, page 84) had been used in part to take care of some of the advances of money paid out by Scott through the escrow No. 167. (pp. 130, 131.) (The total given by Scott is $60,623.02 at page 131. The items given by him aggregate but $45,323.02.

The letter page 84 shows, however, the advancing of $21,277.08 in excess of what went for common stock and to the company's creditors. In the $21,277.08 is $6742.53 paid other than through Scott for preferred stock.) Peters testified (pp. 96, 97):

"He showed me that letter in answer to my inquiry as to what had happened to the $40,000.00. That letter accounted for the $40,000.00. That letter is Respondent's Exhibit 'B'. They did renew the $40,000.00 note to the Westinghouse Company. He did not say to me that the note had been renewed for an amount which was the original amount less royalties, and that the royalties were less than $1000.00. He merely told me he had renewed the note under the pressure of the Westinghouse Company, and that they were going to refuse to renew the note any longer and were pressing Mr. Hays and Mr. Diehl.

Q. Did he not also say this: that when they made the contract, they thought the returns from the royalties would be so great that it was understood between Westinghouse Company and these three men that one-half of the royalties would go to the Patent Company, the Wise Patent & Development Company, and the other half should be applied on the note? Didn't he say that?

A. He told me that was the original agreement, and he expected the royalties to pay off the note within two years.

Q. Didn't he say this to you, too: that the royalties had been so little that the Westinghouse Company had insisted that the whole of the royalties be applied on the note which was renewed?

A. He said they had been reduced, and because no—*no payments had been made on the*

principal—and that they had insisted on the renewal of the note, and that all royalties be applied to the note.

Q. In other words, they were not prepared to pay off the note when its due date arrived, they got it renewed, and that Westinghouse Company insisted that all the royalties that came in on this contract should be applied on that note?

A. Yes." (pp. 96, 97.)

Sad to say, it was still wholly unpaid when this trial occurred.

Not a word of evidence was offered as to whether petitioner Berkeley Pattern Works did or did not know of the contract of February 27, 1930.

By every principle of law and common sense, Olin and Sites were, more than four months prior to the filing of the original petition herein, charged with knowledge that Wise, the president of this corporation, had made a private contract through the use of the patents of the corporation and were charged with knowledge that this contract was to yield him personally an undisclosed profit. They had actual knowledge of the substance of the deal he made.

The very records of the court wherein this case was tried showed Waddell knew, and he had his client Palm swear, that Wise, Hays and Diehl had cooked up a scheme to get the patents *wrongfully and that they had made a contract to divide* the stock of Wise Patent and Development Company ⅓ to Wise, ⅓ to Hays and ⅓ to Diehl and that the deal was a fraud on the rights of the unpaid shareholders. Waddell was attorney for *Olin* and *Sites*. Palm sued for himself

and for other preferred stockholders in Standard Die & Tool Company, to-wit: Henderson, Chapman, Carney, Christensen and Huff. They had not *seen* every term of these contracts made by these three men and would not have understood them if they had, but they and their attorney claimed in plain terms that the transfer of the patents was wrongful and that it was a fraud *and that the whole patent transfer should be set aside.* (Palm Complaint, pp. 87 to 94.)

To "know" a conspiracy to take patents, it is not at all essential that the injured party shall know the hundred and one minor oral or written agreements the conspirators may make. The essence here of the crime charged was that the patents were the only property of substantial value of the corporation; that on February 27, 1930, Wise, though president, agreed in a private capacity with Diehl and Hays to get the patents into the Wise Patent and Development Company; that he pretended they were sold for $25,000.00;

> "* * * that to effectuate said concealments said Will H. Hays, Ambrose N. Diehl and Roy T. Wise, falsely represented to said creditors and stockholders, that the said patents had been disposed of for the sum of $25,000.00."
>
> Finding V (a). (p. 40.)

And Peters testified to that as coming from the lips of Wise in 1933. He was investigating for shareholders. (p. 70.)

And Olin testified, speaking of the men in the shop:

> "The impression we all had was that the patents were sold for $25,000.00." (p. 162.)

Now, Palm and his attorney Waddell knew this was false in the year 1931 and Waddell was then attorney for Olin and Sites and no one testified for the third creditor Berkeley Pattern Works. They knew—if it was ever stated—that this transfer was no pure sale for $25,000.00 which went to Wise Manufacturing Company. If that were true, what earthly right had they to sue Hays, Diehl and Wise? What right had they to call for Wise's stock as provided in the Declaration of Trust?

The Court will note that the investigation undertaken by the witness Peters which lead to these proceedings did not begin until October 1932 (p. 43, Peters) and that this investigation was over two years after the patents involved had been transferred and the transfers thereof recorded and that his investigation occurred about a year and a half after the property of the Wise Manufacturing Company had all been sold out and it had quit business. With everyone knowing what had become of the patents and that a corporation with a significant name had been created, which had received the same, to-wit: Wise Patent and Development Company, Mr. Peters starts his investigation as if he could discover this fact. He visited Wise in Berkeley at intervals starting in October 1932 (p. 43), and extending down to the time when he was handed a copy of the contract of February 27, 1930. Mr. Cerini, attorney for the petitioning creditors, saw this contract at this time. This was the first week in March 1933. (pp. 84, top of page.) Peters testified (p. 62):

> "I went down to Mr. Wise's home one evening, and told him—well *I asked him what had become of the patents, who held them at that time,* and what had been received for them. This was the first time he ever mentioned it. He brought out this contract of February 27, 1930, and he told me that he and Mr. Diehl and Mr. Hays had entered into the contract in New York on that day *and that no one had ever seen that contract outside of those three persons,* and that he would be willing to let me look it over with the understanding that I would not disclose the contents of the contract to anyone."

With everyone knowing that the patents had been disposed of, with everyone knowing that Wise had acted adversely and had been privately concerned in the disposition of this property of the company, with everyone knowing that Hays and Diehl, two strangers, were also in on the deal, with preferred stockholders claiming that they had a case against Hays because of this very transfer, we have this late investigation used as an excuse for non-discovery of the so-called fraud. Think of this testimony of Peters. He states:

> "I asked him what had become of the patents, who held them at that time," etc.

The fact that Mr. Peters was introduced to the affairs of the Wise Manufacturing Company over two and a half years after it had disposed of its patents affords little excuse for the delay in asking the question which he did ask of Wise "at that time".

We commend the present distinguished counsel for the petitioning creditors for their ability but this Court

will note that Cerini thought so little of this so-called case of concealment that when he filed the original bankruptcy petition, he said not one word about the transfer of the patents or the paper of February 27, 1930, one of the understandings of the "conspirators" as to their interests in such transfer. (Original petition, pp. 4 and 5.) It was not until the additional counsel came into the case that the theory was adopted that, by seizing one item of the understandings among the "conspirators" as to their sharing in the benefits of the transfer and claiming that such item was not known until "the first week in March 1933" a contention could be successfully made that the assets of this corporation were concealed until said date.

The Palm complaint showed more nearly than did the amended petition in this case, the consideration which the contract that Wise made with his "co-conspirators" yielded. That complaint showed what had become of the patents. The Wise declaration of trust prepared in April, 1931 (p. 133), had asked that stockholders should ratify the transfer and holders of 80 out of the remaining 195 shares did so. (pp. 137 to 145.) About ten per cent continued to hold out, saying to Wise that he had no right to ask for the ratification. (pp. 175, 176.) It is not relevant that a month, or six months, or a year before Wise made his deal with Hays and Diehl he might possibly have made a better contract. This case of concealment cannot be founded upon any such absurd ground. And we earnestly urge that Wise could not have concealed from Peters late in 1932 or early in 1933 the whereabouts

of these patents by representing that the company sold them for $25,000.00; that Peters could not at this late day have been fooled by the cloak of a sale for $25,000.00—a valid binding sale for $25,000.00. Not a word of testimony showed the representation was made to anyone else. Peters must have known that such a sale was inconsistent with the request for ratification contained in the declaration of trust. That it was inconsistent with what the Palm suit showed. And that it was inconsistent with the pursuit of Hays with hired attorneys. It is a striking thing that the simple question was not put to Peters as to whether he believed the statement that the patents were sold for $25,000.00.

The only creditor who claimed that any information had been passed out that the patents had been "sold" for $25,000.00 was the petitioning creditor Olin and he stated that was the impression "in the shop" (p. 162), and the Court will note that after the witness' attention was called to the fact that he had signed a note and deed of trust for $25,000.00, he testified as follows (pp. 163, 164):

> "Later on the company became indebted to me. I do not recall the fact that a resolution was adopted authorizing the execution of the $25,000.00 second deed of trust with chattel mortgage provision. This was several years ago and I have had no chance to refresh my memory. * * * I remember getting the information that the $25,000.00 check had been sent to the bank so that payment of the creditors could start and taking up of the stock."

He further stated (p. 167):

> "A. It runs through my mind that I did sign a note as secretary of the company but I believe that was all right. I believe it was authorized. It was probably the $25,000.00 note that I signed. At that time it was fresh in my memory, but that is three or four years ago."

Was Waddell, attorney for Palm and attorney for Olin and Sites, permitted to simply sleep until this kind of case was thought of? Bankruptcy inquisition is very, very effective and some have felt it is also at times very unrestrained. But bankruptcy practice does not mean that the attorney for creditors can know for three years that three men are charged with being crooks and may be called "the unholy three" holding the property of a bankrupt corporation or its proceeds in the form of stock and that because every term of that arrangement is not known, the statute does not run.

The petition said the patents were the only property the corporation had which was of any considerable value. Its plant was plastered with an $18,000.00 loan. It owed $25,000.00 in addition. The petition in bankruptcy said Wise, by his domination of the corporation, placed these patents in subjection to the contract of February 27, 1930. Peters testified that the patents were the only property of the corporation of any value. He saw that the promise of $75,000.00 had been eliminated—

> "* * * he further testified that the company had no assets whatever other than the patents." (p. 120.)

Now all the stock was not bought up and this created the chance—and Peters saw it—to say that Wise put these patents in the Wise, Hays and Diehl personal deal. But he has no right to claim, as a witness standing for the stockholders, that he believed there was simply a sale of the patents for $25,000.00 when his client Palm was claiming that he knew well enough to back it up with a verified complaint that that was nonsense and that the patents were wrongfully transferred.

White knew that there was a deal on between Wise, Hays and Diehl and he exacted the price of a $1000.00 for refraining from asking about the profit and stock that Wise was getting. And he did not let the shareholders for whom he acted sign the trust agreement that Wise tendered to Bank of America on April 3, 1931. (pp. 135 and 137 to 145.) Apparently the thing that the shareholders did not like about this trust agreement according to the testimony of Peters, was that it allowed paying the balance of the indebtedness to Owens before making any distribution among the preferred stockholders. Paragraph 1 of the Declaration of Trust (p. 141) recited that the transfer made by Wise to the Trustee would be subject to the Owens indebtedness. Paragraph 2 (p. 144) recited that the Wise stock in the Wise Patent and Development Company was held in pledge by Owens.

Now, if the money from Owens was a borrow, did Peters really have the right to believe that the $25,000.00 was the sale price of the patents and if it was at any time understood as Olin says at the shop

or if it was represented *as the findings say* that the patents were sold for $25,000.00, were not the shareholders able to ask when they were being solicited, beginning in April 1931, to sign the trust agreement, what amount Owens did claim against the Wise stock? It is almost trivial to contend that the transfer of the patents for stock was concealed by the representation. Certainly Palm, et al. did not so believe in November 1930, and not a word of Palm's testimony so indicates. *When the lie is discovered, you can no longer accept the statements of the liar and you are charged with notice.* (See *Ruhl v. Mott,* 120 Cal. 668.) About half of the shareholders signed up the trust agreement. (pp. 175, 176.) Palm, et al. stayed out and continued to compliment Wise, Hays and Diehl as the smart gentlemen who had wrongfully obtained the stock of the Wise Patent and Development Company. (Testimony of Palm, p. 155.)

The balance of the Declaration of Trust (p. 142 and following) provides for the distribution of what is yielded out of the Wise Patent and Development Company stock. Wise, who was by far the largest holder of stock in the California Corporations proposed by this Declaration of Trust, to subordinate his interests to the claims of the other preferred stockholders who had not been paid. But the Palm stockholders would not accept this arrangement. Just at the close of the testimony, proof was offered that a group of the preferred stockholders had accepted this Declaration of Trust. However, Mr. McMahon and the Palm stockholders refused to accept it. It was

shown (pp. 172 to 178), that following the meeting at the Mark Hopkins Hotel herein referred to, Attorney Waddell had received from Mr. Dobrzensky the Declaration of Trust, the name of W. P. Woolsey being inserted in the Declaration as Trustee, and twenty-one of the preferred shareholders accepted this Trust. (pp. 175, 176.) But what right did they have to be asking Wise individually for five cents if they accepted as true the statement that he had sold the patents for the $25,000.00, the sum used in paying their own creditors?

Waddell filed the complaint. Peters testified that Palm told him that he had hired Waddell because he had been an officer and director of the company. (p. 86, bottom page.) The name of George F. Sharp (p. 94) is signed on the complaint as attorney, but the files show (p. 94) Waddell was one of the attorneys and it was admitted throughout that he was the attorney for Palm. The finding is that the cause of action for damages, or in the alternative, the cause of action for rescission, was concealed until early in 1933. A party does not have forever to file a case in rescission. The case of *Ruhl v. Mott,* 120 Cal. 668 declares:

> "But when thereafter he discovers that he has been put upon and defrauded as to one material matter, notice is at once brought home to him that the man who has been false in one thing may have been false to him in all, and it becomes incumbent upon him to make full investigation."
>
> *Ruhl v. Mott,* 120 Cal. 668, 677.

We submit that a contract is no longer concealed when the claimant has ascertained that the contract

was obtained through fraud or breach of trust and has further ascertained the most valuable contents of the contract. Here, stock in a new corporation.

The theory is that the patents are the thing of great value that the corporation's patents are the consideration for the stock of Wise Patent and Development Company. Then is it not true the chief "case" against Hays and Diehl and Wise is the claim to this stock they got or to damages for conversion of it or to rescission with a view to getting the patents back?

We, of course, appreciate that Section 3 of the Bankruptcy Act is not worded precisely the same as are the sections of our Code of Civil Procedure which limit the time for commencing a fraud case. Subdivision 4 of Section 338, C. C. P. provides—

> "An action for relief on the ground of fraud, mistake, or conspiracy. The cause of action in such case is not to be deemed to have occurred until the discovery by the aggrieved party of the acts constituting the fraud, mistake or conspiracy."

It has never been held that to constitute discovery it is essential that the defrauded party shall ascertain every conceivable circumstance or fact that makes up the fraud. There would never be discovery if this was the rule.

Judge Sawyer in the case of *Teal v. Slaven*, 40 Fed. 744, repeated a discussion which he had presented in a previous decision. This discussion opens with the following statement:

> "To ascertain of what acts a discovery of the facts constituting the fraud affording the ground for relief consists, we must go to the principles established in equity law where the idea was derived. The settled principles on this point are that the party defrauded must be diligent in making inquiry, that the means of knowledge are equivalent to knowledge; *that a clue to the facts, which if followed up diligently would lead to discovery is, in law, * * * equivalent to knowledge*", etc.

Judge Sawyer then proceeds to refer to and quote from various cases including decisions of the United States Supreme Court. Assuming that there was no duty imposed on the shareholders of the corporations because of the confidential relation that Wise sustained towards them, still confidence can no longer be imposed when breach of trust is known and the rule certainly applies "that the means of knowledge are equivalent to knowledge; that a clue to the facts which if followed up diligently would lead to discovery is, in law, * * * equivalent to knowledge". The stockholders here knew at the very outset that Wise was quitting them. He was making a bargain for the benefit of Wise. He would not tell them what the terms of the deal were. But Waddell found out and Palm knew that he, Hays and Diehl had used the patents of the company to get stock in Wise Patent and Development Company. Waddell and Palm had this information in 1931. This court in the following case lays down the law with respect

to discovery of fraud in language which is about the same as that used by Judge Sawyer.

Davis v. Willey, 273 Fed. 397.

The last mentioned case cites a California case which declares:

> "And all that reasonable diligence would have disclosed, plaintiff is presumed to have known; means of knowledge in such a case being the equivalent of the knowledge which it would have produced. (Wood v. Carpenter, 101 U. S. 135; Teall v. Slaven, 40 Fed. Rep. 774.)"
>
> *Truett v. Onderdonk,* 120 Cal. 581, 589.

Think of arguing that Peters acting for Palm is deceived in 1933 by a statement from Wise that in 1930 there was a genuine sale of the patents for $25,000.00. Yet we may fairly state that the findings (p. 40) show that very theory. Two years of history were simply forgotten. Two years in which stockholders were saying we know there was no valid sale. Both the signers and the hold-outs on the trust agreement were all saying that—all saying Wise owed them something.

> "It is sufficient to start the running of the statute that the facts were discovered by an attorney employed by plaintiff; and the courts very generally hold the means of discovery to be equivalent to discovery; *and the fraud is considered to be discovered when the creditor is in possession of sufficient facts to put a person of ordinary intelligence and prudence on inquiry which, if pursued, would lead to the discovery.*"
>
> 27 *Corpus Juris,* p. 762.

We submit the four months period is not a meaningless limitation.

In the following case the plaintiff relied upon fraudulent transferring of property and the question was as to whether limitation ran against the case under a statute reading:

> "If any person liable to an action shall *conceal* the fact from the person entitled thereto, the action may be commenced at any time within the limitation after the discovery of the cause of action."

And the court held that such a statute means that facts are no longer concealed when a person would be put on inquiry; that when you are warned as to fraud, you cannot shut your eyes, remain supine and say fraud is still concealed. The court said:

> "Statutes of limitation are vital to the welfare of society and are favored in the law. They are found and approved in all systems of enlightened jurisprudence. They promote repose by giving security and stability to human affairs. An important public policy lies at their foundation. They stimulate to activity and punish negligence. While time is constantly destroying the evidence of rights, they supply its place by a presumption which renders proof unnecessary. Mere delay, extending to the limit prescribed, is itself a conclusive bar. The bane and antidote go together."
>
> *Wood v. Carpenter,* 101 U. S. 807; 25 L. ed. 808.

> "It will be observed, also, that there is no averment that during the long period over which the transactions referred to extended, the plaintiff

ever made or caused to be made the slightest inquiry in relation to either of them. The judgments confessed were of record, and he knew it. It could not have been difficult to ascertain, if the facts were so, that they were shams. The conveyances to Alvin and Keller were also on record in the proper offices. If they were in trust for the defendant, as alleged, proper diligence could not have failed to find a clew in every case that would have led to evidence not to be resisted. With the strongest motives to action, the plaintiff was supine. If underlying frauds existed, as he alleges, he did nothing to unearth them. It was his duty to make the effort."

Wood v. Carpenter, 101 U. S. 807; 25 L. ed. 808.

Consider paragraph 13 of the Palm complaint filed by Waddell on November 30, 1931:

"Par. 13. That on or about the 5th day of March, 1930, said *Roy T. Wise by reason of his said control of the common capital stock of the said Wise Manufacturing Company, and by reason of his control of the common capital stock of the said Standard Die & Tool Company, caused the directors and officers thereof to transfer the said patents, and all the assets and business of said corporations, and each of them, to the Wise Patent & Development Company, a Delaware corporation.* That the plaintiff is informed and believes and therefore states the fact to be that the capital stock of said Wise Patent & Development Company was and is divided into 1000 shares of preferred capital stock of the par value of $100.00 per share, and 2500 shares of common capital stock of no par value. *That plain-*

tiff is informed and believes and therefore states the fact to be that all the said capital stock, of said Wise Patent & Development Company, except for approximately five qualifying shares, is owned share and share alike by the defendants, A. M. Diehl, W. H. Hays and Roy T. Wise. That the defendants Wise Patent & Development Company, A. M. Diehl, and W. H. Hays, secured their respective interests in said patents, assets and business as hereinabove set forth with full knowledge of the representations made to said stockholders by said Roy T. Wise, and with full knowledge that the said transfer of said patents, assets and business was and is a fraud upon the rights of said preferred stockholders herein named. That the said stockholders herein named in Paragraph No. 9, have received nothing for their shares of preferred capital stock, for which the sum of $100.00 per share was paid by them. That the common stockholders of said Wise Manufacturing Company have been paid the sum of $20.00 per share for their stock; and that the holders of the common capital stock, and of certain shares of the preferred capital stock of said Standard Die & Tool Company have received the par value of their said shares after said March 5th, 1930." (pp. 91 and 92.)

The charge was a one hundred per cent cleanout.

Would the accusation have been any sweeter if the complaint had shown that Wise, by reason of his control of the corporation, had, in conjunction with Hays and Diehl, taken from it $100,000.00 and converted that into stock of a corporation? They say the patents could have been disposed of for $100,000.00.

What does filing a law suit mean?

Waddell was not produced as a witness but Peters had seen him and he told Peters he knew that there was fraud in the deal made by Wise, Hays and Diehl. (pp. 100, 101.)

> "A. No. They filed that suit, Mr. Waddell told me he figured from the complaint—just what he told me after I read the complaint—that there was *fraud* involved in the transaction some place, that he did not know very many of the facts, but *he did know the patent had been transferred out of the Wise Manufacturing Company,* or had been assigned, and that he did not know what had been received for it.
>
> Q. Then Waddell told you that when he drew that complaint he knew that fraud had been practiced upon the stockholders and everyone concerned in the Wise Manufacturing Company, did he?
>
> A. No, he did not. He said that there was *some fraud involved in the whole case, but he did not know for sure;* in fact, he said he knew very little about the whole situation, even as a director of the company."

And paragraph 15 and the prayer and verification of the Palm complaint were:

> "Par. 15. That the said transfer of the said patents, business, and assets of said Standard Die & Tool Company and said Wise Manufacturing Company dated on or about March 5th, 1930, *was and is a* FRAUD *upon the preferred stock holders* named in Paragraph 9 and upon plaintiff. That the proceeds of said transfer have been distributed contrary to and in violation of the

Articles of Incorporation of said Standard Die & Tool Company *and in fraud of the rights of stockholders* of said company herein named. That the defendants A. M. Diehl, W. H. Hays and Wise Patent & Development Company were and are parties to said transactions and knowingly participated therein."

The complaint prayed that the defendants should be compelled to pay the plaintiffs the full par value of the stock or that the defendants Wise, Diehl and Hays *should be required by the Court to cause the defendant Wise Patent and Development Company should retransfer the patents to the Standard Die and Tool Company.* The complaint prayed for general equitable relief, and for costs. An affidavit was attached to the complaint, reading as follows:

"Franklin C. Palm, being first duly sworn, deposes and says: That he is the plaintiff in the above entitled action; that he has read the foregoing complaint and knows the contents thereof; that the same is true of his own knowledge, except as to those matters that he believes it to be true.

Franklin C. Palm."

(pp. 92 and 93.)

Waddell sued for Palm and he was attorney for Olin and Sites. What did Palm say on his cross-examination?

"I verified that complaint. He asked me to sign it and I glanced at it, but I did not know what it was all about.

Q. You did not know you were suing Mr. Hays, Mr. Diehl and Mr. Wise?

A. Oh, yes, I knew that.

Q. They have been referred to here as the 'unholy three'. Had they been referred to as the 'unholy three' before you caused this suit to be filed?

A. No, not exactly referred to in that language.

Q. Had they been referred to in language indicating that they were three very *smart* gentlemen who had succeeded in *getting all the stock* of the Wise Patent and Development Company?

A. Yes, *I probably referred to them in that way* myself." (p. 155.)

And they had Hays on the carpet in 1932. On August 23, 1932, a meeting was held at the Mark Hopkins Hotel in San Francisco and that meeting was attended by White, by Waddell, acting as attorney for preferred stockholders, by Mr. Eltse for Wise, by Mr. Dobrzensky, acting for Hays and by Mr. McMahon, a preferred stockholder, who refused to accept the Wise trust hereinafter referred to and before that meeting, as testified to by White, it was rumored about that the three men—Hays, Wise and Diehl—had the stock of the Wise Patent and Development Company. He testified:

"Mr. Waddell had reported that for a period of five or six months previously to the San Francisco meeting, he had been unable to serve Mr. Hays in the case of Palm v. Diehl, the law suit that has been mentioned in the testimony here. I believe there was no mention at this meeting of any agreement whereby Mr. Hays and Mr. Wise and Mr. Diehl had become equal owners of

the stock in the Wise Patent and Development Company.

Q. You believe not? Had you heard that prior to your going there?

A. I heard the three names mentioned. It was rumored *about before the meeting ever occurred that those three men had the stock of that corporation.*

Q. But its purpose was to see Hays, because at that time, and for several months prior thereto it was a known or rumored fact that Hays had received stock in this corporation *and that there was some obligation on the part of Hays to make return to the stockholders of the Standard Die & Tool Company?*

A. *The stockholders felt they had a case against Mr. Hays."* (p. 151.)

What kind of case? Doubtless the same one which now shines so brilliantly in the findings prepared by counsel and which states that they have a two way cause of action *all of which was concealed until within four months of the filing of the original petition,* to-wit, either a case for damages against Hays, or a suit in rescission against the new company.

Does concealment exist in spurts and prevail as a matter of convenience in favor of claimants?

Consider Finding VII:

"The court further finds that this entire case and the transactions above set forth, on the part of said respondent, and said Will H. Hays, Ambrose N. Diehl and Roy T. Wise, are tainted with fraud and concealment and warrant a full and

complete investigation through the processes of the bankruptcy court."

One may question what would have happened to the stockholders and creditors of Wise Manufacturing Company if all this money had not been put up and hazard the statement that Mr. Wise in his capacity for persuasion and promotion converted the much criticized Mr. Hays into a rotund gentleman dressed in red and long white whiskers. Certainly we may fairly contend that this record shows not a vestige of testimony to base a finding upon that he conspired to defraud existing creditors when his first act was to send $25,000.00 to pay them in full. Mr. White testified the first check carried Hays' signature. (p. 150.)

The case presents confusion in theory. It is claimed in effect that the corporation ratified three contracts which were made by its president in his own name and with property of the corporation and that this property represented the only property of the corporation of any considerable value. But Mr. Peters, attorney for the preferred stockholders is not at all agreeable to this. Although the third contract of September 1, 1930, tied up all of the Wise one-third interest in the stock in the new corporation as well as his interest in the stock of the Wise Manufacturing Company (see end of Par. D, p. 115) Mr. Peters does not say at all that the Wise Manufacturing (the stock ownership in which is primarily stock ownership in the holding company, having preferred stockholders whom he represents) did legally ratify this contract or will stand

for this contract. His position is that Hays and Diehl have no rights to stock in the new company, no right to say that the transfer arrangement shall stand. He will not abide by the declaration of trust, although that, to the extent of the par value of the remaining preferred stock (pp. 137 to 145 and 175, 176), subordinated the Wise interests to the claims of preferred stockholders and called for a ratification of the transfer of the patents to the new company. On February 2, 1933, he had himself substituted as the attorney in the Palm case. (p. 94.) And that action still stands and the complaint prays that the transfer of the patents to the new company shall be set aside. Counsel do not dismiss the Palm suit, virtually saying that when it was filed on November 30, 1931, the preferred stockholders knew enough to justify the filing of that suit and that they did not obtain that knowledge only after Mr. Cerini saw the contract of February 27, 1930. There is no more of a severance of plan than there was when Waddell was representing Palm and was representing two of the petitioning creditors.

But our defense here does not depend on any nice distinction as to what position the corporation has taken, or what position it is in law bound to take. The plain facts are that the preferred stockholders and their attorney yelled "faithless" to Wise in 1930, started a suit through Waddell in that year to set aside the transfer of the patents, brought such pressure to bear on Wise that he took action to appease them and did appease part of the complaining stockholders, asserted demands against Hays, and claimed

they had a case against him for his collusion with Wise, and they made him hire an attorney—all on the theory that the transfer of the patents was wrongful and fraudulent and in violation of the trust duties of Wise. Yet the creditors who are also represented by Waddell, although he does not appear as one of the attorneys for the petitioning creditors, come into Court and claim that there was no "discovery" until March 1933, because it was not until then that Wise trotted out a paper that showed one of his understandings with Hays and Diehl through which it is claimed the fraudulent structure had been built and had been standing for three years.

The case rests on the erroneous contention that there was no discovery of the wrongful nature of the transaction, inclusive of the contracts that made it, or of the rights of the corporation until the verbiage of the oral and written agreements of the "conspirators" was known.

POINT III.

Obviously the court's findings depart from the pleadings and the order is founded on what is not alleged. The $75,000.00 chose in action mentioned in the amended petition simply was not proven. The findings on the point were improper. The final tri-party contract cancelled that. (pp. 116, 119.) The findings ignore this or gloss it over by the general statement that the contract of February 27, 1930, was modified

by two later contracts "which provided for certain contingent payments to respondent". This finding is untrue. (pp. 117, 118.) The record shows the absurdity of the effort to claim the case was one of concealment of the literal terms of the contract of February 27, 1930. We have shown that the court's findings went altogether beyond the fragmentary statements of the amended petition relative to the transfer of the patents. We have shown that it was not proper to plead an agreement between Wise, Hays and Diehl was represented by the contract of February 27, 1930, because that contract was modified in substantial particulars. We are not trying to be unduly critical of the petition, but we do call the court's attention to the fact that Peters had all of the books and records of the corporation for six weeks and that he was permitted to take copies of these books and records. Moreover, Wise showed them not only the contract of February 27, 1930, but he told Peters and Cerini of the other two contracts. Cerini in speaking of the conversation between himself and Wise and Peters said:

> "Mr. Wise, in the conversation referred to the fact that there had been two other contracts, I believe." (p. 83, bottom of page.)

We contend that as counsel for petitioners invited a construction of the petition which would permit them to go into the entire dealing between Wise, Hays and Diehl, they are not to be permitted to say that their clients escaped the evidence as to discovery of

the deal wherein the president of the corporation, acting with Hays and Diehl, obtained the patents of the corporation. The contract of February 27, 1930, was but a part of the plan.

Dated, Berkeley, California,
December 19, 1934.

Respectfully submitted,
CLARK, NICHOLS & ELTSE,
Attorneys for Appellant.